

## Seiko Group Corporation

### FY22 Q2 Consolidated Results Presentation - Summary of Q&A

- ◆ Date : Wednesday, November 9, from 15:00 - 16:00
- ◆ Place : Online Web conference
- ◆ Respondent : Shuji Takahashi, President  
Shimesu Takizawa, Director, Executive Vice President

#### **Summary of Q&A**

Q1. You have said that an economic downturn in Europe and the United States is a risk factor for the second half. Have there been any downward trends visible, for example, in retail store sales or distributors' inventories?

A1. Until October (the beginning of our 2Hf), we saw no clear downward trends in finished watches. We expect that the effects of the downturn will become more evident from here on than they were in the first half. At present, watch sales have not clearly fallen, but sales of movements, which were driven by the U.S. market until the first quarter, fell in the second quarter. Orders in both the North American and European markets have begun to decline. Given this trend, we expect more challenges in the mass-market price range in both those markets, and will focus on selling our Global Brands (GB) to underpin sales.

Q2. If the economy slows, how will it affect the market for watches in the higher price range?

A2. Past trends in Japan indicate that an economic slowdown produces a large impact on watches in the lower price range, but no significant change in the highest price range (above 10 million yen). In Grand Seiko's price range (around 1 million yen), the market usually dips slightly, but recovers quickly. In general, we expect that the lower price ranges will be affected by any economic slowdown, but the impact on the higher price range will be much less.

Q3. How do you see inbound demand in the second half? Surely inbound demand will be affected by the weaker yen, which could boost sales. How do you see the impact of inbound demand in the second half?

A3. In the past, inbound demand accounted for 10% to 15% of sales, with roughly half of that attributable to Chinese tourists. Now, with very few Chinese tourists able to come to Japan, we expect this segment will account for only a few percent of total sales in the second half.

Q4. Returning to the issue of an economic downturn, both in Japan and overseas, could you tell us about what strategies you are considering to cope with that scenario in the second half?

A4. As I'm sure you noted, in our full-year forecast, figures for the second half are lower than those for the first half. The impact of exchange rate changes will be positive, but energy and other costs will rise. We have also factored in the negative effects of an economic slowdown in China, Europe, and the United States. Consequently, our second-half results were already forecast to be lower than those in the first half.

As I mentioned before, higher-priced watches are less susceptible to economic downturns than lower-end products. With that in mind, we will focus on Global Brand strategies to mitigate the impact of a possible market downturn. We will also continue working to increase the share of Grand Seiko sales in overseas markets.

Q5. Regarding those GS strategies, I would like to ask if we can expect Seiko to continue developing GS distribution channels even if demand for those products weakens.

A5. We believe there is plenty of scope for developing new distribution channels, not only in the United States, but also in Europe. We recently established a GS sales company in Singapore to cover the Asia-Pacific region. We plan to promote the development of new distribution channels and steadily increase our market share.

Q6. Prices appear to be comparatively low in Japan. Are you considering narrowing the gap between retail prices in Japan and overseas?

A6. We are aware that exchange rate fluctuations have caused a gap between prices in Japan and abroad. However, we have not yet decided when we will revise domestic prices.

Q7. The operating margin rose, reflecting an increase in gross margin and the curbing of increases in the SG&A ratio. Can we expect the operating margin to continue to rise? It seems reasonable to think that strengthening your brands would generally help improve the gross margin. Can we expect that you will hold down SG&A expenses to strengthen the Watches Business, or are expenses likely to increase?

A7. Before the pandemic, it was natural to allocate substantial funds to advertising via high-priced media such as television and magazines. However, during the pandemic we increased the use of online media and digital technology, and we are shifting more of our budget in that direction. We started using online marketing overseas before trying it in Japan. Just as one example, we are now connecting online marketing with physical events, which has been quite successful.

I should note that there was a delay in introducing online approaches here in Japan, but

we are now increasing our digital footprint and using our marketing budget much more effectively. Where marketing costs used to increase in proportion to sales, we can now increase sales without increasing costs. We will continue to develop online marketing strategies and pursue other initiatives that help to control SG&A expenses.

Q8. How significant was spending by inbound tourists in Japan in the second quarter?

A8. Not very significant. According to information from the WAKO store, spending by inbound tourists started to rise around August. Although we believe that spending definitely rose from August to October (when Japan was re-opened to foreign tourists), because there are still so few Chinese tourists, we expect overall inbound consumption to be half or less of the pre-pandemic level.

Q9. Do you have any information on people arbitraging the price gap between Japan and the US, such as making commercial purchases for resale?

A9. We know that there have been some purchases intended for resale. We revised restrictions on inbound tourists in stages, in June and in October. Purchases by foreign nationals traveling to Japan on business (as opposed to group tours) have been increasing. In general, spending by inbound tourists began to recover gradually from the first half, and it has been recovering noticeably since October (when Japan was re-opened).

Q10. Your forecast for the second half appears to be rather conservative. What specific cost items do you see as a drag on profit growth?

A10. Increases in energy costs are probably the most significant factor. Specifically, electricity costs for clean rooms and other manufacturing facilities have been rising in both our domestic and overseas operations. We consider further rises in energy costs to be a major risk factor for the second half.

Q11. Could you provide us with a breakdown of sales of finished watches by region (including China) in the second quarter?

A11. Sales in Japan remained flat from the first to second quarter. First-half sales in the Americas rose by more than 20 percent, actually in the high 20s. Sales in Europe rose in the high teens. Sales in most other regions fell in the first quarter, but rose in the high teens in the second quarter. China was the only exception.

Q12. Does that mean that sales in China were weak in the second quarter?

A12. The Chinese market was our only global market where sales fell. In China, sales fell more than 50% in the first quarter and then dropped by around 50% in the second quarter.

Q13. What factors accounted for the increase in operating profit margin in the Devices Solutions Business?

A13. There was some improvement in the product mix. We were able to increase marginal profit thanks to an increase in sales and, to a lesser degree, from exchange rate gains. We were able to properly turn an increase in sales into an increase in profit.

Q14. In the next 18 months (to the end of FY2023), how do you see sales trending in the Systems Solutions Business? Specifically, what will happen in the payment-related, IoT-related, and system-related businesses in that period?

A14. In the payment-related business, results will be generally stable to some degree, although there will be temporary effects from a recovery in the domestic food service industry. In the IoT-related business, a large part of revenue is non-recurring, so sales are expected to fluctuate. In the system-related business, we received orders for long-term projects from major financial institutions in September, which should support steady growth in that business. Based on this outlook, we aim to achieve growth in both revenue and profits in the end of fiscal year 2023 (March 31, 2024).

Q15. I noted a substantial adjustment in the operating profit forecast by segment. How can you estimate the full-year adjustment at the beginning of a fiscal year?

A15. The adjustment includes corporate administrative expenses, the amortization of goodwill, and consolidation adjustments. Administrative expenses and goodwill estimates are incorporated into the initial budget. There will be no significant changes there unless unexpected factors arise. And consolidation adjustments do not change significantly unless the Group's businesses change.

Q16. I have another question about price hikes to narrow the gap between prices in Japan and overseas. The number of visitors to Japan is increasing, and commercial purchases for resale are increasing. If the price gap is not corrected, there is a significant risk of a decline in brand value. Shouldn't you take immediate action to address the problem and support brand value in the long term, even it means a small decline in sales volume now? I assume you are urgently discussing price hikes internally, but as yet there has been no action. Is there some problem with the decision-making process?

A16. You are absolutely correct when you note that the price gap between Japan and overseas is a critical issue for brand management. We believe pricing policy is very important for creating a unified GB image. And, as you suggest, there is constant discussion about how and when to initiate price hikes. The fact that we have not yet reached a final decision does not point to a problem with decision-making, but rather, to the complexity of the

problem.

We need to choose the right timing so that our price hikes are not seen as merely taking advantage of the falling yen. We must also consider increases in energy costs, the effects of cost increases at our suppliers, and the effects on inventories in choosing the right timing. It is also essential that our actions are seen as enhancing trust in the brand. In short, our decision needs to balance many different factors.